

**BEFORE THE COMMISSIONER OF FINANCIAL INSTITUTIONS  
STATE OF TENNESSEE**

<b>IN THE MATTER OF:</b>	)
	)
<b>SENTINEL TRUST COMPANY,</b>	)
Hohenwald, Tennessee,	)
	)
<b>AND</b>	)
	)
<b>Danny N. Bates, Clifton T. Bates,</b>	)
<b>Howard W. Cochran, Bradley S. Lancaster,</b>	)
<b>Gary L. O'Brien</b>	)
	)
<b>Members of the Board of Directors of</b>	)
<b>Sentinel Trust Company,</b>	)
Hohenwald, Tennessee,	)
	)
<b>Respondent.</b>	)

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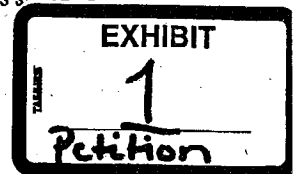
**EMERGENCY CEASE AND DESIST ORDER**

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The Commissioner of the Tennessee Department of Financial Institutions ("Commissioner"), having determined that he has reason to believe that the Respondent, Sentinel Trust Company, Inc., has engaged in unsafe and unsound banking practices and that the Respondent's circumstances warrant immediate action, hereby issues the following **EMERGENCY ORDER TO CEASE AND DESIST**, pursuant to Tennessee Code Annotated, §§ 45-1-107(a)(4), (a)(5) and (c).

**I. AUTHORITY**

The Commissioner is vested with the power to issue this **EMERGENCY CEASE AND DESIST ORDER** in this proceeding pursuant to T.C.A. §§ 45-1-



107(a)(4), (a)(5) and (c). Sentinel Trust Company, Hohenwald, Tennessee, is a trust company subject to the Commissioner's jurisdiction and the Company's directors, who are responsible for management and policies, are persons subject to his jurisdiction.

## **II. FACTUAL ALLEGATIONS**

1. Sentinel Trust Company was originally formed under the Tennessee Business Corporation Act.

2. Pursuant to Public Chapter 112 of the Acts of 1999, as codified at T.C.A. § 45-1-124, a company engaged in activities subject to the Tennessee Banking Act on July 1, 1999, but formed prior to the enactment of Public Chapter 620 of the Acts of 1980 and not previously subject to regulation by the Commissioner, may continue to act as a fiduciary without submitting an application. However, such entity shall be otherwise fully subject to the Banking Act.

3. Sentinel was engaging in fiduciary activities on July 1, 1999 and has been subject to regulation by the Commissioner since that time.

4. On June 16, 2003, the Department began an examination of Sentinel Trust Company. During the examination, Sentinel's audit firm, Charles Welch and Associates, Nashville, withdrew and declined to complete the December 31, 2002 audit of the company due to the inability to obtain evidence needed to evaluate the fair value of certain receivables. The Department's trust examiner has been unable to determine the accuracy and validity of fiduciary cash reconciliements and other corporate and fiduciary financial statements and records in order to determine the solvency of the company. (See affidavit of Vivian Lamb attached to the Notice of Charges as Exhibit "A").

5. The Commissioner met with the Board of Sentinel Trust on October 6, 2003 to discuss the urgency of obtaining a financial statement audit.

6. Thereafter, on October 10, 2003, Sentinel President Danny Bates advised the Department's trust examiner that Kraft CPAs, ("Kraft") located in Columbia, Tennessee had been engaged to perform an audit of the company as required by T.C.A. § 45-2-402(c) and Department Bulletin B-02-2 as of December 31, 2002.

7. Subsequently, Kraft advised the Department's trust examiner that the audit was impeded due to the inadequacy and questionable accuracy of Sentinel's fiduciary and corporate cash records and reconcilements.

8. Kraft informed the Department that Sentinel had retained an independent contractor to reconcile the corporate and fiduciary accounts.

9. On January 7, 2004, Kraft issued an audit report as of December 31, 2002. The Department obtained a copy of the audit on March 19, 2004.

10. As of the December 31, 2002 audit, Kraft identified fiduciary accounts receivable of approximately \$9.4 million, of which approximately \$7.5 million resulted from expenditures made in connection with defaulted bond issues and related unreimbursed costs and expenses. The Auditors stated that the company's records were not adequate for them to satisfy themselves as to the existence, amount or collectability of these receivables. Kraft noted that Sentinel has a fiduciary duty, as trustee, to safeguard assets under administration and could be held responsible for any shortfalls. Kraft could not determine the liability, if any, which could result from the ultimate resolution of this matter.

11. Because of the materiality of the matter discussed in item 10 above, Kraft declined to give an opinion because Kraft stated that the scope of their work was not sufficient to enable them to express, and they did not express, an opinion on the financial statement of Sentinel Trust Company. Kraft has commenced an audit as of December 31, 2003, but to our knowledge, this audit has not been completed.

12. As the Department understands and as Kraft's audit noted, in the normal course of business Sentinel makes various commitments and incurs certain contingent liabilities that are not represented on its balance sheet. As of the December 31, 2002 audit, Kraft noted that Sentinel was a defendant in a lawsuit alleging breach of its fiduciary duties in connection with the issuance of certain corporate notes. Kraft further noted that counsel for Sentinel has asserted that an award of damages is unlikely, but could reach \$2,500,000.

13. On April 5, 2004, the Department sent a letter to Sentinel requesting an opinion of counsel regarding Sentinel's practice of funding defaulted bond expenses with funds from other non-related bond issues (See Exhibit A attached to the Notice of Charges). This letter stated that it was the Department's understanding that Sentinel serves as the indenture trustee for various high-yield, unregistered municipal and corporate bonds. In some instances, the debtor fails to make the scheduled principal and interest payments and default is declared per the terms of the indenture. Oftentimes the debtor will seek bankruptcy protection, which triggers an automatic stay and prevents any action from creditors until a plan of reorganization, debt restructuring and/or sale of collateral is approved by the bankruptcy court.

Further, the Department stated that it was its understanding that Sentinel, in its role as indenture trustee, in many instances funds various expenses relative to these defaulted issues, such as insurance, security, legal and other professional fees, in an effort to protect the value of the underlying collateral. The governing indenture and/or bondholder indemnification usually provides for the reimbursement of these expenses from the proceeds of the sale of the collateral. However, since Sentinel does not have adequate corporate liquidity to fund these expenses, it appears that Sentinel usually "borrows" from other non-related bond issues to fund these expenses. This is done by writing checks and/or wires on a pooled demand deposit account held at SunTrust Bank, Orlando, Florida. President Bates has stated that this is a "common industry" practice. Finally, the letter requested that Sentinel provide a written legal opinion addressing the legal basis of such practice.

14. In response to the April 5, 2004 letter, Sentinel's counsel requested a meeting with the Commissioner. On April 28, 2004 Sentinel's Executive Vice President Paul Williams and Sentinel's attorneys Alex Buchanan and David Lemke met with the Commissioner. At this meeting, Counsel for Sentinel indicated that the practice of funding defaulted bond expenses with funds from other non-related bond issues was inappropriate. They indicated that the expenses attributable to defaulted bonds are typically funded with corporate assets.

15. At the April 28, 2004 meeting, counsel, on behalf of Sentinel, requested permission for Sentinel to continue on a temporary basis the practice of "borrowing" funds from one bond issue to cover the expenses of unrelated defaulted bond issues. The Commissioner declined to approve that request.

16. Counsel for Sentinel also stated at the April 28, 2004 meeting that Sentinel's fiduciary cash shortfall is believed to be between \$8-10 million.

17. On April 30, 2004 the five members of Sentinel's Board and their counsel met with the Commissioner. At that meeting President Danny Bates stated that Sentinel's most recent calculations show that Sentinel had a deficit fiduciary cash position of seven million two hundred fifty thousand dollars (\$7,250,000). However, Mr. Bates indicated that this figure fluctuates daily. Finally, Mr. Bates stated that Sentinel's corporate cash account had a current balance of fifty three thousand dollars (\$53,000). This Department believes that this amount of cash is inadequate to pay the operating capital needed for the administration of the defaulted bonds for the immediate future.

### **III. CHARGES**

Having considered these factual allegations and the entire matter as a whole, and based in part upon the preliminary findings of the Department's ongoing examination which commenced on June 16, 2003, the audit findings of Kraft CPAs, and the statements by company personnel and their counsel, the Commissioner has determined that Respondent, Sentinel Trust Company, has engaged in unsafe and unsound banking practices including, but not limited to:

1. Operating in an unsafe and unsound manner by using the pooled fiduciary funds to provide operating capital for non-related defaulted bond issues. This practice has created a fiduciary cash shortfall which changes on a daily basis. President Bates informed the Commissioner on April 30, 2004 that the shortfall is \$7,250,000 (seven

million two hundred fifty thousand dollars.) This shortfall greatly exceeds Sentinel's current operating capital;

2. Operating with an inadequate level of capital for the kind and quality of accounts held under administration;

3. Operating in an unsafe and unsound manner by failing to reconcile fiduciary cash and corporate cash accounts in a timely and accurate fashion; and

4. Operating in an unsafe and unsound manner by failing to keep accurate books and records.

#### **IV. ORDER**

**IT IS HEREBY ORDERED** that Respondent, Sentinel Trust Company, its directors, officers, employees, agents, successors, assigns and other institution-affiliated parties of Respondent, **CEASE and DESIST** from the following unsafe and unsound practices:

1. Engaging in the practice of using the pooled fiduciary funds to provide operating capital for non-related bond issues;

2. Entering into any agreement to sell or transfer corporate assets without the Commissioner's prior written approval;

3. Selling or transferring fiduciary accounts including the appointment of successor or substitute trustees without the Commissioner's prior written approval;

4. Engaging in any transactions, including but not limited to, loans, investments or change of investments or purchase of assets with respect to any accounts

under administration and/or Respondent's own capital and assets, in excess of \$50,000 without first obtaining the written approval of the Commissioner;

5. Entering into any new contracts or agreements in which Sentinel agrees or is obligated to perform the duties, responsibilities or role of a fiduciary, trustee, paying agent, bond registrar, transfer agent, fiscal agent or similar responsibilities without the prior written approval of the Commissioner;

6. Making any changes in existing management and control of Respondent unless the Commissioner gives prior written approval to make any such changes;

7. Making any payment in the form of dividends;

8. Making any payment in the form of increases in salary, bonuses, management fees, capital distributions, or other similar types of payments or compensation without the prior written approval of the Commissioner; and

9. Paying any director fees, including any salary that is intended to compensate an employee for their service on the board.

**IT IS FURTHER ORDERED** that Respondent, Sentinel Trust Company, its directors, officers, employees, agents, successors, assigns and other institution-affiliated parties of Respondent, take the following affirmative actions:

1. Make an initial infusion of capital in the amount of two million dollars (\$2,000,000) in cash by the close of business on May 17, 2004. Sentinel shall then apply that two million dollars (\$2,000,000) to partially replenish the fiduciary pooled demand deposit account exclusive of Sentinel's fees;

2. Submit to the Commissioner a capital plan outlining the Company's plans to completely replenish the fiduciary pooled demand deposit account. In addition, the plan



should outline steps to be taken to provide sufficient operating capital (as determined by the Commissioner). This plan shall be submitted to the Commissioner by May 17, 2004 and an update provided by the 17<sup>th</sup> of every month thereafter;

3. Provide a spread sheet to the Commissioner as of April 30, 2004, by the close of business on May 4, 2004, identifying each bond issue in which Sentinel serves in any capacity with original par value, current amount outstanding, next principal payment due date, next interest payment due date, current status (default or performing), collateral value, (if any) and the current balance of all related sub accounts under the issue. This spread sheet shall be updated regularly and submitted to the Commissioner with the monthly capital plan;

4. Allocate necessary resources to return Sentinel's books and records to an accurate state; and thereafter preserve and maintain the property, books, records, documents, databases and/or computer files and/or any other property of or information pertaining to Respondent, Sentinel Trust Company; and

5. Immediately notify the Commissioner in writing of any litigation in which a judgment has been entered against Sentinel. This notification shall be made regardless of whether the judgment is final.

The provisions of this **ORDER** shall be binding on the Trust Company, its directors, officers, employees, agents, successors, assigns and other institution-affiliated parties of the Trust Company.


The provisions of this **ORDER** shall not bar, stop, or otherwise prevent the Department or any other governmental entity from taking any action affecting Sentinel,

its directors, officers, employees, agents, successors, assigns, and other institution-affiliated parties of the Trust Company.

The provisions of this **ORDER** shall be effective and enforceable except to the extent that, and until such time as, any provision of this ORDER shall have been modified, terminated, suspended or set aside by the Commissioner.

This **EMERGENCY ORDER TO CEASE AND DESIST** shall become effective immediately.

ISSUED THIS 3<sup>rd</sup> day of May, 2004.

  
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KEVIN P. LAVENDER, COMMISSIONER  
Tennessee Department of Financial Institutions